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In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS OF CITIZENS UTILITIES COMPANY ON THE ACCESS REFORM NOTICE OF PROPOSED RULEMAKING

CITIZENS UTILITIES COMPANY

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SUMMARY

Although they are price cap-regulated, the Citizens LECs do not fit the profiles of the more typical price cap LECs -- the BOCs and GTE. The Citizens LECs serve primarily suburban and rural areas that are generally more costly to serve than the mix of urban, suburban and rural properties served by the more typical price cap carrier. A fundamental flaw in the *Access Reform NPRM's* discussion of a "market-based" approach to future price cap regulation, at least as applied to rural price cap LECs is the proposed tying of Phase 1 regulatory relaxation to the wrong criteria. The contemplated "potential local exchange competition test" is clearly appropriate for the typical price cap LEC; its is inappropriate for the unique circumstances of a rural price cap group such as the Citizens LECs. Rural price cap LECs require Phase 1 flexibility, but have generally not received the type of interconnection requests that would be required under the potential local exchange competition test. The "prescriptive" approach should be rejected out of hand as a form of rate of return regulation made even worse.

The Citizens LECs have invested substantial dollars in bringing state of art communications services to rural communities, an investment that could be unduly jeopardized by regulatory changes that incorrectly treat rural price cap LECs in a similar manner as the more typical price cap carriers. Further, the Commission should examine why so few LECs with an option have selected price cap regulation and tailor its ultimate regulations to making that form of regulation more, not less, attractive to rural LECs.

The Citizens LECs believe that, for purposes of interstate access charges, the presence of a competitor for access transport services in an exchange area of a rural price cap LEC is sufficient to trigger two events: (i) Phase 2 treatment of <u>all</u> access services in that exchange area; and (ii) consideration of whether the particular service or services subject to

competition should be deregulated and detariffed. The triggering event in a rural price cap LEC exchange area should be either the presence of a single interexchange carrier or other competitor securing access transport services in the exchange area through its own facilities, those of a competitive LEC or those of the incumbent LEC, either through expanded interconnection or unbundled transport network elements. The key feature of Phase 2 relief for a rural price cap LEC would be the opportunity to provide differential pricing for access to different classes of customers. This feature would allow the rural price cap LEC the necessary flexibility to meet competition for multi-line business access customers, for example, while still maintaining a greater degree of regulatory control over prices of services not yet subject to a significant degree of competition, *e.g.*, residential and single-line business customers.

The Citizens Companies generally endorse the *Access Reform NPRM's* proposals for restructure of the Commission's Part 69 access structure. In particular, they recommend replacement of usage sensitive carrier common line charges with flat per-line charges assessed upon end users' Primary Interexchange Carriers.

Finally, the Citizens Companies believe that the Commission must create an transitional recovery mechanism to address incumbent LEC depreciation reserve deficiencies. The need for such a recovery mechanism is particularly acute in the case of rural price cap LECs. The historic regulatory compact is an implicit contract that regulators must consummate even though the regulatory and competitive regime is changing.

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COMMENTS OF CITIZENS UTILITIES COMPANY
ON THE ACCESS REFORM NOTICE OF PROPOSED RULEMAKING

Citizens Utilities Company, on behalf of itself and its telecommunications subsidiaries (hereinafter referred to, collectively, as the "Citizens Companies"), by its attorney, hereby submits its comments on the CC Docket No. 96-262 Notice of Proposed Rulemaking, released December 24, 1996, initiating the Commission's interstate access reform proceeding (the "*Access Reform NPRM*") and shows as follows:

I. Introduction

Citizens Utilities Company, through divisions and subsidiaries, provides local telecommunications services, electric distribution, natural gas transmission and distribution, and water and waste water treatment services to more than 1,600,000 customer connections in 20 states. Citizens Utilities Company subsidiary incumbent local exchange carriers (the "Citizens LECs") provide local exchange services in suburban and rural exchange areas in Arizona, California, Idaho, Montana, Nevada, New Mexico, New York, Oregon, Pennsylvania, Tennessee, Utah and West Virginia.[1] In addition, Citizens Telecommunications Company, another Citizens Utilities Company subsidiary, provides interexchange services throughout the nation and competitive local exchange services in several states. Finally, another Citizens Utilities Company subsidiary, Electric Lightwave, Inc., provides competitive local exchange and interexchange services in Arizona, California, Idaho, Minnesota, Nevada, Oregon, Washington, and Utah.

The Citizens Companies are a microcosm of the telecommunications industry. The Citizens Companies include incumbent local exchange companies serving areas of 12 states, a long distance carrier and competitive exchange carriers. As such, the Citizens Companies strive to reach a balance of competing interests in forming regulatory positions and strategies. Achieving that balance is never easy, and it is particularly difficult in a proceeding that is as complex and of such critical importance as this. The *Access Reform NPRM's* emphasis upon the heavy hand of regulation to achieve the laudable goal of enabling market forces to supplant price regulation of interstate access services, at least as applied to rural price cap LECs such as the Citizens LECs, complicates the process of arriving at straight-forward, common sense solutions to many of the thorny issues posed in this proceeding.

The Citizens Companies believe that an overhaul of the access structure is long overdue and was necessary far before enactment of the Telecommunications Act of 1996 (the "Telecommunications Act").[2] In addition, the *Access Reform NPRM* bravely opens up a necessary

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[1] The rural nature of the markets served by the Citizens LECs is described in Section II and Exhibit 1, *infra.*

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *to be codified at* 47 U.S.C. §§ 151 *et seq.* Hereinafter, all citations to specific provisions of the Telecommunications Act will be to specific sections as codified in the Communications Act of 1934, as amended (the "Communications Act").

inquiry into transitional treatment of incumbent LEC embedded costs in an era of emerging competition. The Citizens Companies welcome the *Access Reform NPRM* to the extent that it finally triggers the necessary inquiry into access reform and the thorny issue of transitional recovery of incumbent LEC embedded costs. Enlightened resolution of these issues is a necessary complement to the Telecommunications Act's local exchange market opening initiatives and tools.

However, at least for rural price cap LECs such as the Citizens LECs, the *Access Reform NPRM* attempts to go many steps, if not light years, beyond restructure of the existing interstate access regime. The extra-legislative regulatory tools contemplated by the Commission in the *Access Reform NPRM* to lower access prices are inappropriate for rural price cap LECs. Moreover, the contemplated "one size fits all" thinking behind these approaches assumes that all price cap carriers are similar in profile to the Bell Operating Companies ("BOCs") and GTE. In at least one case, that of the Citizens LECs, no such analogy (other than the election to come under price cap regulation) exists. The blind application of either of the new regulatory approaches contemplated in the *Access Reform NPRM* to possibly the only price cap LECs that are both small and primarily rural in nature -- the Citizens LECs -- would be particularly inappropriate and potentially injurious.

Because of their particular view of the *Access Reform NPRM*, the Citizens Companies' comments are structured in a different order from that of the *Access Reform NPRM*. First, these comments will show that, even though the Citizens LECs are incumbent LECs under price cap regulation, they cannot and should not be lumped together with the more typical price cap LECs. Second, they will address the many and severe flaws inherent in the *Access Reform NPRM's* exploration of new forms of regulation intended to achieve the Commission's view of what competitive results should look like. The Citizens Companies find it important to address this issue early in the course of their comments. Substantial regulatory relaxation of rural price cap LEC access pricing is justified by the creation of statutory interconnection rights under Section 251 of the Communications Act. Third, the Citizens Companies will also suggest reforms that should be implemented for rural price cap LECs without a tie to the burdensome "triggers" contained in the current notion of a market-based regulatory framework. Fourth, they will address the Part 69 structural reforms outlined in the *Access Reform NPRM.* Finally, they will address an issue of paramount importance to the Citizens LECs -- creation of a mechanism within the price cap regulatory structure to allow at least rural price cap LECs the opportunity to recover the difference between interstate embedded costs and forward-looking economic costs prescribed as a result of access reform and the development of competition.

II. Dispelling The Myth That All Interstate Price Cap-Regulated LECs Are Similarly Situated

A. The Citizens LECs Are Different From All Other Price Cap LECs

The *Access Reform NPRM* states that "[t]he need for access reform is most immediate for those incumbent LECs that may soon be subject to competition from the availability of unbundled network elements. These are primarily the price cap incumbent LECs."[3] This statement is generally correct. It is, however, unduly simplistic in that it assumes that all price cap carriers are similarly situated to the BOCs and GTE in terms of serving a mix of urban, suburban and rural areas. Obviously, the initial competitive thrust into local exchange markets centers on the urban

[3] *Access Reform NPRM* at ¶ 52.

and larger suburban markets served by the bigger price cap carriers. Most business customers are located in these urban and larger suburban markets.

The Citizens LECs do not fit into the BOC and GTE profiles because, unlike the more typical price cap carriers, the Citizens LECs serve primarily suburban and rural areas. In order to illustrate this point, Exhibit 1 hereto depicts year-end 1995 exchange profiles for 25 of 225 Citizens LEC exchanges (approximately every tenth exchange, in alphabetical order) in three states, New York, Tennessee and West Virginia.[4] The Charles Town, West Virginia market, approximately one and a quarter hours drive from the Commission's offices in Washington, DC, is a good example of a Citizens LEC fringe suburban market. While this market is in the Washington, D.C. Metropolitan Statistical Area, it is a relatively tiny market with a year-end 1995 average of 90 access lines per square mile. A good example of a Citizens LEC rural exchange area in the same state is the Davy exchange. It is remote, impoverished and sparsely populated. It is a minuscule market with an average of 27 access lines per square mile. It also has another characteristic that is typical of virtually all exchanges served by the Citizens LECs -- a low proportion of business access lines in relation to residential access lines. Most of these business lines are associated with very small business enterprises.

Of course, the BOCs and GTE serve some extremely rural areas. However, unlike the Citizens LECs, they also serve the largest urban and suburban populations in the same states in which they provide service to rural communities. Again, to use West Virginia as an example, Bell

[4] 1996 exchange profiles for these three states will be completed in February 1997. In addition, more generalized exchange demographics are available for all Citizens LEC properties. The page limit imposed upon these comments precludes attachment of all of the 225 exchange area profiles for New York, Tennessee and West Virginia or the more generalized data for other states. This latter data, updated for 1996, will be made part of *an ex parte* filing.

Atlantic-West Virginia, Inc. serves many rural locations, but it also serves such urban centers as Charleston, Huntington and Morgantown. The difference between the Citizens LECs and the BOCs and GTE is significant. Unlike the larger price cap LECs, the Citizens LECs are almost exclusively in high cost markets and may not be able to achieve comparable levels of overall efficiency. Moreover, in Citizens LEC rural areas, the loss of even a small number of customers can result in a much higher proportionate loss of revenue than is the case in larger markets of the type served by more typical price cap carriers.

Lack of brand recognition is another factor that distinguishes the Citizens LECs from the typical price cap carriers and the major interexchange carriers that are the most probable competitive entrants in the Citizens LEC markets. The "big three" interexchange carriers and the larger price cap carriers that are contiguous to the Citizens LECs' service areas are national and regional enterprises, respectively, that can effectively and economically advertise in the broadcast radio and television media and in newspapers and magazines. These entities, because of their size and service coverage, are able to blanket the local media with constant and effective advertisements for their services. In contrast, the Citizens LECs are not able to use cost-effectively the same advertising media because that media is not limited in transmission scope to the relatively small Citizens LEC service territories.

Recent surveys reflect the advertising disadvantages under which the Citizens LECs labor and, ultimately, their competitive disadvantage in relationship to other potential market entrants. During the second quarter of 1996, the Citizens Companies commissioned a "baseline" customer loyalty and brand image survey by Cambridge Reports/Research International of Cambridge, Massachusetts ("Cambridge"), to be followed by quarterly tracking surveys. The initial survey involved interviews of 1,400 Citizens LEC residential customers between April 2-14, 1996, and interviews of 1,400 Citizens LEC business customers between April 5-26, 1996. The initial Cambridge survey showed that Citizens LEC residential and business customers recognize the following carriers' names and express awareness of those carriers in the following proportions:

Carrier Name	Percentage of Customers Expressing Brand Awareness	
AT&T	Residential	86%
	Business	87%
MCI	Residential	71%
	Business	69%
Sprint	Residential	60%
	Business	65%
Citizens	Residential	50%
	Business	56%
Other	Residential	17%
	Business	18%

The Telecommunications Act also created another factor that indisputably separates the Citizens LECs from most, if not necessarily all, other price cap LECs -- Section 251(f)(1) of the Communications Act. Each Citizens LEC is, pursuant to Section 3(47) of the Communications Act, a rural telephone company with the exemption specified under Section 251(f)(1).[5] Moreover, the Citizens LECs have not, at the time of submission of these comments, received a single request for unbundled network elements or resale of local exchange services. The only interconnection requests that the Citizens LECs have received are for the transport and termination of local traffic to and from wireless and competitive local exchange carriers. The Citizens Companies do not view the Section 251(f)(1) exemption as a tool to fend off or hamper competition in the Citizens

[5] "[S]ection 251(f) exempts rural telephone companies for the requirements of Section 251(c)(2) until the rural telephone company has received a bona fide request for interconnection, services, or network elements, and the state commission determines that the exemption should be terminated." *Access Reform NPRM* at fn. 88.

LECs' exchange areas. The exemption only serves to ensure that interconnection arrangements in rural telephone company areas are, in light of the uniqueness of those areas, technically feasible; do not demonstrate an undue economic burden; and are consistent with Section 254 universal service provisions.

While not similarly situated to the BOCs and GTE in terms of market profile or requests for interconnection, the Citizens LECs have an immediate need for access reform. The Citizens LECs are already experiencing access competition and did so long before passage of the Telecommunications Act. That access competition has taken at least two forms. The first form has occurred when interexchange carriers supplant a Citizens LEC's switched access services by direct connection to the few large business customers present in an exchange area. This type of competition also usually results in a loss of local exchange business, such as Centrex service. A good example of this was in Citizens Telecommunications Company of Utah's Howell, Utah exchange. This remote, rugged exchange has only two significant business customers, large contractors to the Air Force and automobile industry, respectively. Some years ago, their access traffic was switched to special access arrangements connected to a large PBX. Citizens' Utah LEC understands that both customers would like to retrench their PBX operations and move to long-term arrangements for cost-based Centrex and access services. Large interexchange carriers are in the position to meet this potential demand today. Rural incumbent LECs cannot presently meet that demand, in large measure, because of the current rigidity of the Part 69 structure. Without immediate Phase 1 access reform flexibility, rural price cap LECs stand to lose both interstate access traffic and the opportunity to compete for large customers' local exchange business.

The second form of access competition that the Citizens LECs already face is through competitive local exchange carriers extending into a Citizens LEC fringe suburban exchange included in a large metropolitan-based Extended Area Service ("EAS") area. A good example of this is in Elk Grove, California, a suburban exchange located approximately 25 miles from Sacramento, California that is in the Sacramento EAS area. The present rigidity of Part 69 prevents the Citizens LECs from meeting this competition or from effectively planning to meet additional levels of competition as they develop.

A fundamental flaw in the *Access Reform NPRM's* discussion of a market-based approach to future regulation of price cap carriers, as applied to rural price cap LECs, is the proposed tying of Phase 1 regulatory relaxation to the wrong criteria. The *Access Reform NPRM* suggests conditioning a price cap carrier's entry into market-based Phase 1 treatment upon a showing of five basic indicia of potential access services competition (the "potential local exchange competition test").[6] The Commission's proposed potential local exchange competition test's elements are: (i) the availability of geographically unbundled network elements at Total Element Long Run Incremental Cost ("TELRIC"), plus a reasonable allocation of common cost; (ii) the availability of local traffic transport and termination at cost-based rates; (iii) the offering of retail services to resellers at wholesale prices equal to retail prices minus the reasonable avoidable costs of providing wholesale rather than retail service; (iv) a demonstration that competitors are able to actually order and receive elements and services in a commercially reasonable manner and in necessary quantities; and (v) other factors such as the provision of dialing parity and access to rights-of-way and whether

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[6] There are other shortcomings, at least as applied to rural price cap LECs, in both the market-based and prescriptive regulatory approaches discussed in the *Access Reform NPRM*. They are addressed in Section III, *infra*.

network standards are open and non-discriminatory.[7] The potential local exchange competition test is clearly appropriate for the typical price cap LEC; it is not appropriate, however, for a rural price cap LEC such as the Citizens LECs.

The marketplace reality is that the Citizens LECs have not received, and do not know when they may receive, the type and volume of interconnection requests necessary to meet the proposed potential local exchange competition test. It would be patently unreasonable to force on the Citizens LECs the burden of demonstrating existence of the five potential local exchange competition elements to trigger Phase 1 treatment without actual demand for the underlying services from potential competitors.[8] The expense and burden of complying with this type of requirement at the federal level, coupled with the uncertainty of state commission approval and interconnector demand, would, for small, rural carriers, be overwhelming. Moreover, imposing such a requirement upon rural telephone companies is legally dubious. It appears to conflict directly with Communications Act Section 251(f)(1)'s requirements for the subject LEC's receipt of a *bona fide* interconnection request and a state commission's decision that the rural telephone company exemption should be terminated.

The fact that the Citizens LECs serve markets that may not experience local exchange competition as quickly as the markets served by the more typical price cap carriers does not mean that regulatory relaxation for access services is any less necessary. Regulatory relaxation may be

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[7] *Access Reform NPRM* at ¶¶ 168-176.

[8] In addition, several of the pricing-related features in the five indices of potential competition are stayed while undergoing judicial review. A cynical observer might conclude that use of the five indices, as written, represents an effort to compel compliance with what the FCC intended its interconnection rules to be, rather than what may be legally permissible. If the Court of Appeals finds that the FCC's interconnection rules exceeded the scope of the agency's authority, the agency should not be allowed to do indirectly, through a tying of unlawful interconnection requirements and regulatory relaxation, what it cannot do directly through its interconnection rules.

necessary sooner than in larger markets for a very simple reason -- the rural price cap carrier has proportionately fewer sizable customers to lose than do its more urban counterparts. These customers represent a large proportion of the revenues of the Citizens LECs. Furthermore, the Citizens LECs experienced such losses even before passage of the Telecommunications Act of 1996 and expect the situation only to worsen without rationalization of Part 69 and related regulatory strictures. At least in the case of rural price cap LECs, the full panoply of Section 251 interconnection tools is not indispensable to the presence of some measure of access competition and loss of exchange access business. The potential local exchange competition test contemplated in the *Access Reform NPRM* is inappropriate for application to rural price cap LECs.

B. A Rural Price Cap LEC's Dilemma

Commencing in 1993, Citizens Utilities Company has made multiple acquisitions of incumbent local exchange properties that have resulted in an expansion of its access lines served from approximately 120,000 to over 800,000. Each of these exchange acquisitions were from companies no longer desiring to maintain, or invest capital in, operations in the rural markets conveyed. The acquisition of these properties reflects the heart of the Citizens Utilities Company business philosophy -- pursuit of opportunities inherent in investment in small and medium-size communities with long-term growth potential. In large measure, Citizens Utilities Company has pursued this strategy largely through acquisition of properties from larger companies whose business focus is not centered in such communities.

The Citizens LECs have already invested and, under appropriate standards, will continue to invest the dollars necessary to ensure that the communities they serve have available the most advanced telecommunications possible. In 1996, the Citizens LECs invested approximately $170 million in capital improvements, a figure that will almost double in 1997. While 1998 investment commitments are not yet finalized, the Citizens LECs expect an expenditure close to that for 1997.

At present, 99% of the Citizens LECs' access lines are served by digital switches. The remainder, which are located in extremely rugged, sparsely settled areas in the Navajo Indian Nation and in Nevada, will be converted during the next two to three years. Further, the Citizens LECs operate approximately 3,000 route miles of fiber facilities.[9] Finally, the Citizens LECs' program of deploying SS7 connectivity in all properties will be complete by mid-1998, enabling all of its rural customers to enjoy such discretionary services as call waiting and caller identification.

The Citizens Companies, like all business enterprises, have a finite amount of investment capital available and seek to deploy that capital in order to garner an attractive, competitive return. Fully understanding that competition will come to the Citizens LECs' exchange areas, Citizens Utilities Company, nonetheless, continues to invest in equipment and upgrades because it believes that its incumbent LECs can profitably compete in the new era. In addition, the Citizens Companies have, in recent years, passed up other investment opportunities, such as PCS auctions. They have chosen, instead, to direct the preponderance of their investment capital to bringing world-class communications services to their rural markets. This business mission, extant well before passage of the Telecommunications Act, is fully aligned with key universal service provisions in that legislation.[10]

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[9] The rugged nature of many of Citizens LEC properties, such as in the Navajo Indian Nation, Northern California and Utah, also dictate heavy usage of point-to-point microwave and Basic Exchange Telephone Radio facilities.

[10] *See* Communications Act Sections 254(b)(2) ["Access to advanced telecommunications and information services should be provided in all regions of the Nation."] and 254(b)(3) ["Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to

Because they are not like the BOCs and GTE in terms of market size or capitalization, the Citizens LECs view with some alarm certain features of the *Access Reform NPRM* that would lump them in with the larger price cap carriers for future regulatory treatment. Absent tailoring of the access and price cap rules that come out of this proceeding to the exigencies of rural price cap carriers, the Citizens LECs may be forced to rethink their commitment to investing heavily in the rural markets that have traditionally been their focus.

C. The Wrong Commission Action Could Make Price Cap Election Even Less Attractive To Other Rural LECs

As the Commission is aware, the Citizens LECs are the only LEC group to elect price cap regulation since issuance of the Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858 (1995).[11] Price cap regulation has not proven to be particularly attractive. Only a few LECs with the option to remain under rate of return regulation have selected the price cap alternative. The federal price cap system continues, in the form of the "sharing mechanism," a discomfiting form of rate of return regulation. The sharing mechanism creates the same disincentive to achieving operating efficiency that exists in rate of return regulation, albeit in a somewhat less severe form. The Citizens LECs, fully understanding the infirmities of the price cap regime, made their election believing that price cap regulation was, under the circumstances, marginally more attractive. Many other carriers have reached a contrary conclusion, which is arguably a referendum on how well price cap regulation is working.

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telecommunications and information services that are reasonably comparable to those services provided in urban areas . . ."]

[11] *Access Reform NPRM* at fn. 451.

The Commission should, in the course of the *Access Reform NPRM* deliberations, ask why more LECs have not elected price cap regulation. More to the point, it should ask whether the rules that are promulgated in this proceeding will make price cap election any more or less attractive. Done incorrectly, those rules may make price cap regulation even less attractive to other LECs. As a representative of rural LECs, the Citizens LECs believe that the course of future price cap regulation must be tailored with recognition that what is appropriate for the BOCs and GTE may not be appropriate for rural price cap LECs. The Commission should take steps to make price cap regulation more, not less, attractive to the large universe of LECs that have so far rejected it. Key among these steps is elimination of the sharing mechanism, at least for rural price cap LECs. At a minimum, the Commission should reject for small LECs an over-broad "market-based" or "prescriptive" regulatory approach that can only serve to make price cap regulation an even less attractive proposition for the many carriers that have not embraced it.

III. Approaches To Access Rate Reform And Deregulation

A. A Properly Market-Based Phase 1 Regulatory Approach Is Appropriate

The *Access Reform NPRM's* discussion of alternative regulatory approaches for price cap regulation suggests that the Commission may not believe that the market entry and pro-competitive tools implemented by the Telecommunications Act will fulfill their intended role. The Citizens Companies believe that the availability of interconnection and other rights to competitors under the Telecommunications Act will discipline incumbent LECs' uneconomic pricing. The Commission, however, appears to presume that these tools may not work. The additional tools discussed in the *Access Reform NPRM* -- a market-based or prescriptive regulatory approach or some combination of the two -- presuppose, at best, that the effectiveness of the Telecommunications Act in fostering competition will take a significant period of time, and at worst, that it will not be fully effective. The Commission's response to its apparent presumption is to consider additional regulatory tools. The experiences of Electric Lightwave, Inc., a Citizens Company, has experienced in interconnecting with BOCs in several metropolitan areas suggests that the Commission's thinking might be correct, if limited in scope to the typical price cap LEC serving such areas. It is not correct, however, when applied to rural price cap LECs.

The Citizens Companies find the prescriptive approach to be abhorrent. It represents a return to a regulatory scheme that is much like traditional rate of return regulation, only worse. At its core, a prescriptive approach is antithetical to the goal of diminishing and ultimately eliminating regulation as competition develops. It would also be contrary to a core principal underlying Section 251 of the Communications Act -- the creation and deployment of tools for competitive marketplace entry. A prescriptive approach to price cap regulation would have the perverse effect of relieving interexchange carriers of any responsibility for using Section 251's provisions and the workings of the competitive marketplace to discipline access pricing. These tools exist for a reason -- they are to serve as the means to constrain local exchange and access prices. It is very unlikely that Congress intended that the Commission substitute its judgment for that of the marketplace in setting access pricing. The Citizens Companies doubt that the discussion of the prescriptive approach has any other real purpose than creating a straw man that is so unpalatable that the proposed market-based approach will appear to be a gem in comparison.

The fundamental flaw in Phase 1 of the market-based approach envisioned in the *Access Reform NPRM,* as applied to a rural price cap LEC, is its tying with the Commission's vision of potential local exchange competition in a given market. Meeting this test would require compliance with the Commission's interconnection rules (many of which are currently under judicial review) to achieve what should be a basic level of regulatory relief generally available to rural price cap carriers. The Citizens Companies believe that the Phase 1 level of regulatory relief -- geographic deaveraging of access charges, the ability to provide volume and term discounts, the opportunity to offer contract tariffs and respond to RFPs and deregulation of certain new services[12] -- should be available, at least to rural price cap LECs, without reference to the Commission's potential local exchange competition test.[13]

At least two reasons exist for not adopting the contemplated *quid pro quo* between rural price cap LEC Phase 1 relief and the potential local exchange competition test. First, rural price cap LECs require the type of flexibility proposed in Phase 1 to meet the access competition that exists independently of local exchange competitors taking advantage of the newly promulgated, statutory interconnection rights. This type of access competition, which relies upon special access and expanded interconnection opportunities in serving large interexchange carrier customers, is virtually impossible for a rural price cap LEC to meet under the current shackles of Part 69. Very few of the Citizens LECs can take advantage of the current expanded interconnection-related flexibility standards allowed for entrance facilities, tandem transport and direct-trunked transport pricing when interconnectors are present at their switch locations. They have few interconnectors in their exchange areas. Second, the Citizens LECs have not received requests for Section 251 interconnection, other than for local traffic transport and termination. Tying Phase 1 relief to the

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[12] *Id.* at ¶¶ 180-200.

[13] *Id.* at ¶¶ 168-176.

Commission's potential local exchange test would exclude the Citizens LECs from a necessary degree of regulatory relief. It is improbable that they would be willing or able to engage in an academic exercise of seeking approval of interconnection arrangements for which no demand yet exists.[14]

One final matter pertaining to the contemplated tying of market-based Phase 1 relaxation for rural price cap LECs to the Commission's over-broad concept of potential competition requires comment. Such a tie would be contrary to the best interests of both rural price cap LECs and interexchange access customers. First, a rural price cap LEC that could not meet the Commission's potential local exchange competition test would not have the opportunity to craft volume and term access agreements or contract tariffs, for example, in the effort to retain access business. Similarly, interexchange carriers would be denied an obvious alternative to the expense and burden of expanded interconnection or seeking local exchange interconnection arrangements. According rural price cap LECs Phase 1 relaxation without a tie to the potential local exchange competition test would provide those LECs with a tool to compete. It would also provide interexchange carrier customers with a method, in addition to those embodied in the Telecommunications Act, to reduce access pricing. The Commission's tying concept in Phase 1, at least with reference to rural price cap LECs, could turn a potential "win-win" situation into a "lose-lose" for access participants.

The Citizens Companies believe that the existence of the tools and policies embodied in Sections 251, 252 and 253 of the Communications Act, coupled with the Section 254 directive to

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[14] Unlike the BOCs under Section 252(f) of the Communications Act, it does not appear that the Citizens LECs have the statutory right to seek state approval of a statement of Generally Accepted Interconnection terms and conditions. Instead, Section 252 contemplates non-BOC incumbent LEC/interconnector individual negotiation and/or arbitration of interconnection arrangements with ultimate state approval of the arrangements.

create a modern, workable universal funding mechanism, are more than sufficient to trigger rural price cap LEC Phase 1, market-based regulatory treatment. These and other provisions of the Telecommunications Act create the tools for the opening of rural local exchange markets and establish the potential for the development of rural local exchange competition. They represent the means by which any potential competitor, including exchange access customers, choosing to do so can enter the market if it believes rural price cap LEC rates to be too high. The fact that many of the Commission's rules implementing these statutory provisions are under judicial scrutiny does not mean that the statutory provisions will not effectively meet their intended purposes. Instead, it means that many parties do not agree with details of the Commission's implementation rules. Those disagreements will be resolved in due course, and incumbent LECs and interconnectors alike will know with greater clarity what their obligations and responsibilities in local exchange market entry.

The Citizens Companies urge the Commission to rethink its *quid pro quo* for rural price cap LEC achievement of market-based Phase 1 relaxation. The new statutory interconnection rights and implementation rules, when in final form, will fully and effectively serve as the platform for potential rural local exchange competition. While competition may develop in a less tidy and widespread fashion than the Commission might like, it will develop where the economics dictate. The necessary tools are in place ultimately to restrain rural price cap LECs' access pricing. They should be allowed to work without prejudgment on the Commission's part that they may not lead to the perfect competitive results that it thinks its own rules might drive.

B. A Recommended Market-Based Phase 2 Approach For Rural Price Cap LECs

An overarching theme of the *Access Reform NPRM* is found in the statement that:

> [r]egardless of the specific approach that we adopt in this proceeding -- market-based, prescriptive, or some combination of the two -- our goal is to foster the development of substantial competition for interstate access services. Once substantial competition is present for a particular service in a particular area, we propose to remove that service from price cap and tariff regulation for that area.[15]

The Commission contemplates a Phase 2 of the market-based approach triggered by a finding of a "competitive presence short of substantial competition . . . [to] allow for further reforms under conditions short of the substantial competition necessary for full deregulation and detariffing."[16] The Commission's concept of Phase 2 is that of an intermediate step between potential and full competition.

In Section II, above, the Citizens LECs showed that most of the exchange areas they serve typically have a low proportion of business lines in relation to residential lines. Most businesses that the Citizens LECs serve are very small. The few large business customers that the Citizens LECs have generate a large proportion of those LECs' total local and exchange access revenues. Because larger business customers generally generate more long distance and access charge minutes than do residential and small business customers, larger business customers present the greatest target for competition in the Citizens LECs' exchanges. Given the low number of larger business customers in those exchanges, any competitive presence, whether by special access or competitive local exchange carrier, is evidence of substantial competition for

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[15] *Access Reform NPRM* at ¶ 149.

[16] *Id.* at ¶ 201.

the access business generated by those customers. As discussed in Section III(C), below, the Citizens LECs expect the opportunity to demonstrate that deregulation and detariffing of access services to that class of customers is necessary when <u>any</u> competition exists in one of their exchange areas.

The *Access Reform NPRM* seeks:

> comment on how to determine when competition is sufficient to [trigger Phase 2 treatment and] end rate structure rules for transport and local switching, remove the ban on differential pricing for access among different classes of customers, eliminate price cap service categories within baskets, and consolidate the traffic-sensitive and trunking baskets.[17]

The Commission must be mindful in structuring a Phase 2 trigger that not all price cap LECs have the market characteristics of the BOCs and GTE. As discussed above, the Citizens LECs serve rural areas almost exclusively. As such, their revenue streams are relatively more dependent upon their small percentage of business customers and generators of significant access usage than are the more typical price cap LECs. Further, the historic universal service scheme compelled pricing for this critical business customer base at levels well above cost, in order to help defray below-cost pricing of residential services. The Citizens LECs' small, but vital base of high-volume customers is the most obvious target for competitors. Whether rural LECs like the Citizens LECs experience competition for their residential customers will be a function of how a new universal service system is structured, something that remains to be seen. The Citizens Companies do not agree with the proposition suggested in the *Access Reform NPRM* that price cap LECs should demonstrate the existence of a competitively neutral universal service

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[17] *Id.* at ¶ 203.